



10401 North Meridian Street
Suite 202
Indianapolis, IN 46290

317.663.4180 *main*
317.815.0871 *fax*
866.353.8422 *toll free*

www.adisa.org

July 14, 2017

VIA Email to: pubcom@finra.org

Ms. Marcia E. Asquith
Executive Vice President, Board and External Relations
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1500

Re: Request for Comment 17-14 on Rules Impacting Capital Formation

Dear Ms. Asquith:

ADISA (the Alternative & Direct Investment Securities Association)¹ appreciates the opportunity to respond to the Financial Industry Regulatory Authority's (FINRA) request for comment as set forth in Regulatory Notice 17-14, which addresses the aspects of operations and processes impacting capital formation currently governed by or expressed in various FINRA rules.

ADISA's membership ranks include firms that are FINRA member firms as well as firms that raise capital through FINRA member firms pursuant to and in accordance with various rules, including Rule 2310. The various FINRA rules that apply to or otherwise involve capital formation are numerous, and we have therefore focused this letter on those rules with particular application to the non-traded alternatives space, and in particular the following:

1. FINRA's Funding Portal Rules;
2. FINRA Rule 2310, applicable to Direct Participation Programs; and
3. FINRA Rules 5122 and 5123, which have application to FINRA member firms when they are engaged in the private sale or placement of securities.

This letter addresses each of these three important areas in turn. ADISA recognizes that other FINRA rules within the scope of the request for comment are important to the capital formation process and the actions of FINRA member firms generally, but has chosen to focus on these

¹ ADISA (Alternative & Direct Investment Securities Association), is the nation's largest trade association for the non-traded alternative investment space. ADISA represents over 4,000 financial industry members, reaching over 220,000 finance professionals, with sponsor members having raised in excess of \$200 billion in equity in serving more than 1 million investors. ADISA is a non-profit organization (IRC 501c6) with the ability to lobby and also has a related 501c3 charitable non-profit (ADISA Foundation) assisting with scholarships and educational efforts.

areas out of a belief that it is best to hone in those rules, etc., with the greatest applicability to our membership on a consistent basis.

Funding Portal Rules

FINRA's rules governing Funding Portals (FPs) are driven primarily by Congressional legislation and actions thereafter by the Securities and Exchange Commission (SEC). Currently, true "crowdfunding" activity – as opposed to activity that involves public offers to sell (and solicitations of offers to purchase), securities and other assets to accredited and other investors pursuant to SEC Regulation D and Rule 506 thereunder – is limited by the dollar limits imposed by Congress in the JOBS Act and the SEC rules adopted pursuant to that legislation. As the role of crowdfunded investment (as is expected), continues to grow in importance and scale, the alternative investment industry expects to participate in this important marketplace for capital raising and new ideas. For the alternative space overall, we believe that future generations will be more likely to invest in our products through crowdfunding and related market mechanisms.²

That said, many of our members who are broker-dealers wonder if the increased use of FPs will ultimately increase the number of firms effectuating crowdfunding strategies outside of FINRA's FP rules and away from its oversight. An increase in the number and size of non-FINRA member distribution portals may act to put at a competitive disadvantage those who are subject to and abide by FINRA regulation. This calls for careful and coordinated oversight among the agencies in approaching this developing area. We applaud all efforts to increase coordination around and the basic approach taken in FP rules, and we hope that this will help encourage FP firms to operate within FINRA regulations. We stand ready to support and assist with all efforts to enhance the role of FPs while looking to ensure an adequate level of investor protection at the same time.

FINRA Rule 2310 – Direct Participation Programs

FINRA Rule 2310 addresses underwriting terms and arrangements in public offerings of direct participation programs (DPPs) and unlisted real estate investment trusts (REITs) (collectively, Investment Programs). These Investment Programs are a core aspect of many ADISA members' offerings.

Due to the complexity of and risks associated with Investment Programs, Rule 2310 includes several provisions intended to promote investor protection. The Rule also promotes fairness by prohibiting unfair and unreasonable compensation. Specifically, Rule 2310 requires that members participating in a public offering of an Investment Program meet certain requirements regarding underwriting compensation, fees and expenses, due diligence, suitability, and limits on non-cash compensation. The Rule also prohibits members from participating in an Investment Program unless the issuer has agreed to disclose valuation-related information to investors.

² 78% of Millennials and 70% of GenXers endorse using alternatives compared with only 58% of boomers (Natixis Global Asset Management Survey, <http://durableportfolios.com>. 2014.

While these are laudable provisions, the Rule also appears to have several important and perhaps unintended consequences. In brief, rather than simply promoting investor protection, the Rule's substantive requirements have shaped and even in some ways determined the distribution-related structure and compensation arrangements associated with a large number of Investment Programs such as non-traded REITs and BDCs. While FINRA's desire to ensure fairness with respect to compensation elements associated with these programs is laudable, the specific limits set forth in the Rule in some ways create inflexible parameters and reflect FINRA's substantive judgment as to which kinds and amounts of compensation are fair and reasonable. This has placed FINRA in the undesirable position of substantively regulating critical aspects of these important programs simply because FINRA member firms wish to offer and distribute interests therein. FINRA should consider replacing the Rule with one that permits broker-dealers, in conjunction with product firms, to determine what is fair and reasonable, as well as how diligence is performed, etc.

FINRA Rules 5122 and 5123

These two Rules regarding offering documents for private placements originated out of FINRA's stated desire to make that information easily available to FINRA staff in the event of a compelling need for it, and not for general oversight purposes. Rule 5123 requires members to file with FINRA, within 15 calendar days of the date of first sale of a private placement, a private placement memorandum, term sheet or other offering document, or indicate that no such offerings documents were used, and Rule 5122 requires members that offer or sell their own securities to file the private placement offering documents at or prior to the first time the documents are provided to any prospective investor. Rule 5122 also establishes standards on disclosure and the use of private placement proceeds.

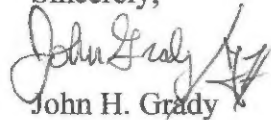
These Rules serve and were intended to establish requirements for information collection. However, in our view, they have morphed into rules that now involve substantive FINRA staff review. While the intent was to require dissemination of information, FINRA is now exercising independent judgement about the investment quality. This overreach should be acknowledged and curtailed.

Conclusion.

In summary, we believe in high quality and appropriate regulation for all of our members and their various activities, including those that are or act through FINRA member firms. Our overriding goal is to ensure that the cost imposed by a regulation is matched or exceeded by the benefit produced thereby. We see increasing evidence in our association of the drain to the smaller broker-dealer community of increased regulation, not just from FINRA, of course, but from other agencies and governmental bodies such as the Department of Labor. If and to the extent that the sale and distribution of "alternative" (i.e., non-correlated) investment programs and products becomes more difficult, the ability for the current and next generation to invest wisely with diversified product decreases, putting savings and returns at greater risk. We call upon FINRA to do its best to consider the whole gamut of factors playing upon the distribution chain to ensure a thriving marketplace for raising capital consistent with investor protection and appropriate costs of compliance.

ADISA appreciates the work that FINRA carries out, and we stand ready to assist further in any way we can. We would be happy to discuss our comments in person or by phone at your convenience.

Sincerely,


John H. Grady
President

cc: Catherine Bowman, ADISA Legislative & Regulatory Committee Chair